



California Public Employees' Retirement System
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Agenda Item 3c

June 13, 2011

TO: MEMBERS OF THE FINANCE COMMITTEE

- I. **SUBJECT:** Annual Internal Audits Risk Assessments
- II. **PROGRAM:** Audit Services
- III. **RECOMMENDATION:** Information Only
- IV. **ANALYSIS:**

The Office of Audit Services completed an annual risk assessment for the purpose of developing our annual audit plan, as required by the International Standards for the Professional Practice of Internal Auditing. The Standards require us to develop a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals. The annual risk assessment is a process of identifying and analyzing both internal and external risks and serves as a tool to effectively allocate audit resources to address critical risk coverage and mandated or periodically recurring audits.

To ensure alignment and eliminate duplication, we leveraged the risk assessment data compiled by Office of Enterprise Risk Management (OERM) in its Risk Heat Map. We cross-referenced the heat map data to our enterprise auditable entities to ensure our audit plan addresses enterprise risk priorities. Audit planning also considers additional factors such as management or Board priorities, timing of audit activities to maximize effectiveness, maintaining a reasonable impact on business activities, and available audit resources.

The risk assessment and audit planning processes take into account constantly changing conditions presenting new challenges to the organization. In particular in the coming fiscal year, Office of Audit Services is planning for a very flexible audit plan to enable us to respond to issues and requests that may arise with the transition and implementation of myCalPERS, and enable us to assist management to effectively address emerging challenges and risks.

Major Risk Assessment Areas

Our risk assessment includes two major components as described below.

Contracting Public Agencies

The Office of Audit Services performs membership, payroll, and health enrollment reviews of contracting public agencies, including cities, counties, special purpose districts, schools, district agricultural associations, the California State University system and state agencies. We evaluate and validate the integrity and accuracy of membership and payroll data reported to CalPERS by employers that contract with CalPERS for retirement, health benefits, or both. Our focus is on compensation reporting, member enrollment, payroll reporting elements, reporting unused sick leave for additional service credit, and employment of retired annuitants. We also review the documentation of members' health enrollment eligibility.

To identify and prioritize contracting public agencies for review, we conduct an annual risk assessment of contracting public agencies. The risk assessment process utilizes factors such as agency size, agency type, safety coverage, history of late payroll reporting, missed payroll reporting periods, highly paid employees, high levels of special compensation, chartered cities, and whether the agency received formal CalPERS training. We then prioritize each entity in low, medium, or high categories of risk scores to determine the best use of staff resources.

<i>Types of Agency</i>	<i>High Score</i>	<i>Medium Score</i>	<i>Low Score</i>	<i>Total Auditable Entities</i>
Public Agencies	282	575	629	1,486
County Office of Ed	10	13	36	59
District Ag Assoc.	1	1	52	54
CSUs	10	10	4	24
State Agencies	31	81	112	224
Total	334	680	833	1847

As directed by the Board in November 2010, we plan to review public agencies that have highly paid employees (exceeding \$245K per year) in fiscal year 2011-2012. Currently 136 public agencies have at least one highly paid

employee, which contain a mix of high, medium and low risk public agencies. Sixty-three agencies assessed as high risk have highly paid employees. We also plan to review other agencies that may be assessed as medium or low risk in response to special requests from management and tips received, a high risk County School system, and some agencies selected at random. We anticipate completing 58 public agency reviews in Fiscal Year 2011-12.

Internal Audit and Consulting Services

Internal Audits performs assurance and consulting work, consistent with the International Standards for the Professional Practice of Internal Auditing. Internal audits addresses areas including retirement, health, investments, information technology, fiscal, operations support, and other internal areas. Internal audits evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts.

Our approach for the internal risk assessment this year was streamlined by leveraging the risk assessment information and analysis prepared by the Office of Enterprise Risk Management. We then mapped the enterprise-wide high risk areas to our existing audit universe. Using this as a base, we then applied our audit-planning perspective and considered risk factors based on criteria that include: assessed adequacy and effectiveness of programmed controls, character and complexity of the business activity and its underlying systems, dollar size or transaction volume, Board or management interest, sensitivity of the application information, results and time of previous audits, and degree of changes in operations. Our proposed audit plan will be presented for approval in Agenda Item 3d.

It is important to note that the risk assessment process has no finish line. It is an ongoing process to identify, mitigate, and monitor existing and emerging risk to the organization.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic Plan, but is part of the audit planning process prescribed by the Finance Committee Charter, the Office of Audit Services Charter and the International Standards for the Professional Practice of Internal Auditing.

VI. RESULTS/COSTS:

The planned work of the Office of Audit Services will provide broad assurance and consulting services for the Board of Administration, its Committees, and CalPERS management.

Staff is available to answer any questions that Committee members may have.

MARGARET JUNKER, Chief
Office of Audit Services

PETER H. MIXON
General Counsel

